

# **REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON MNQUMA LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the financial statements of the Mnquma Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practices (Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act no.56 of 2003) (MFMA), and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

### **Basis for qualified opinion**

#### **Property, plant and equipment**

6. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment, as certain of these assets could not be located during the audit due to the lack of information in the municipality's asset register. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments were required to property, plant and equipment of R488,3 million (2013: R498,6 million) as disclosed in the statement of financial position and note 5.

7. The municipality did not account for its property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment* as certain assets that existed could not be traced to the asset register and financial statements. Consequently, property, plant and equipment as disclosed in the statement of financial position as well as note 5 is understated by R9,6 million (2013: R13,8 million) and accumulated surplus as disclosed in the statement of financial position is understated by R9,6 million (2013: R13,8 million).

#### **Accumulated surplus**

8. I was unable to obtain sufficient appropriate audit evidence to confirm adjustments made to the opening balance in the statement of changes in net assets for all errors identified in the previous and other financial years. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments to the accumulated surplus of R511,1 million as disclosed in the statement of net assets and statement of financial position were necessary.

#### **Commitments**

9. The municipality did not disclose all unrecognised contractual commitments, in accordance with GRAP 1 *Presentation of Financial Statements*. New contracts entered into were not recorded into the commitments register. Consequently, commitments as disclosed in note 33 were understated by R24,9 million.
10. In addition, I was unable to obtain sufficient appropriate audit evidence regarding commitments, as agreements and explanations to support the committed amounts could not be provided. Consequently, I was unable to determine whether any adjustment relating to commitments of R78,2 million in note 33 to the financial statements was necessary.

#### **Depreciation**

11. GRAP 3: *Accounting Policies, Estimates and Errors* requires that an entity corrects material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by restating the comparative amounts for the prior period presented in which the error occurred or if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and net assets for the earliest prior period presented.
12. During the year, the municipality restated the property, plant and equipment but the retrospective correction of errors were not done in accordance with GRAP 3: *Accounting policies, Estimates and Errors*. As a result no depreciation was charged on certain assets whilst only for a portion of the year was charged on others.
13. Consequently, depreciation of R47,1 million as disclosed in the statement of financial performance and in note 27 and accumulated surplus as disclosed in the statement of net assets as well as statement of financial position are understated by R24,1 million.

#### **Irregular expenditure**

14. I was unable to obtain sufficient appropriate audit evidence for the irregular expenditure as management does not have appropriate systems to identify this expenditure.
15. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments to irregular expenditure of R59,3 million (2013: R48 million) as disclosed in note 42 were necessary.
16. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i). Consequently, the irregular expenditure disclosed in note 42 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R17,8 million (2013: R20,7 million).

#### **Value Added Tax receivable (VAT)**

17. I was unable to obtain sufficient appropriate audit evidence for the VAT receivable as management could not explain reconciling differences between the South African Revenue Service records and municipal records.
18. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to VAT of R13,3 million (2013: R11,1 million) as disclosed in note 11 to the financial statements were necessary.

#### **Payables from exchange transactions**

19. I was unable to obtain sufficient appropriate audit evidence for income received in advance of R6,1 million as management does not have adequate records to support this income.
20. Consequently, I was unable to determine whether any adjustments relating to income received in advance in the financial statements were necessary.
21. The municipality did not account for its creditors and accruals as required by GRAP 1: *Presentation of Financial Statements* in the following circumstances:
  - It did not disclose all creditors and accruals.
  - Included in payables and accruals are amounts that do not satisfy the requirements of GRAP 1.
22. Consequently, payables from non-exchange transactions as disclosed in the statement of financial position as well as note 16 and general expenditure as disclosed in the statement of financial performance and note 23 are overstated by R3,4 million.

#### **Unauthorised expenditure**

23. I was unable to obtain sufficient appropriate audit evidence for the unauthorised expenditure as management does not have appropriate systems to identify this expenditure.
24. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments to unauthorised expenditure of R6,5 million (2013: R49,5 million) as disclosed in note 40 the financial statements were necessary.

#### **Prior period error note - donations**

25. I was unable to obtain sufficient appropriate audit evidence to support the prior period errors in respect of donations disclosed in note 36, as agreements and explanations to support the restatement could not be provided. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustment relating to donations of R17 million in note 36 in the financial statements were necessary.

#### **Statement of comparison of budget and actual amounts**

26. The municipality did not always provide all the required explanations for variances and reasons were not always sufficient or supported by evidence as required by GRAP 24: *Presentation of Budget Information in the Financial Statements*. Consequently, the financial statements have not been prepared in accordance with all the requirements of the standard.

#### **Aggregation of immaterial uncorrected misstatements**

27. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, the statement financial performance and disclosure notes to the financial statements:
  - General expenditure as disclosed in the statement of financial performance is overstated by R3,1 million.

28. I was unable to obtain sufficient appropriate audit evidence and was therefore unable to confirm the following elements by alternative means:

- Unspent conditional grants as disclosed in the statement of financial position and in note 14 to the financial statements.
- Conditional grant income as disclosed in the statement of financial performance and in note 21 to the financial statements.
- Consumables as disclosed in the statement of financial position and in note 8 to the financial statements.
- Receivables from non-exchange as disclosed in the statement of financial position and in note 9 to the financial statements.
- Revenue from non-exchange as disclosed in the statement of financial position and in note 19 to the financial statements.
- Revenue from exchange as disclosed in the statement of financial performance and in note 20 to the financial statements.
- Provisions as disclosed in the statement of financial position and in note 15 to the financial statements.
- General expenses as disclosed in the statement of financial performance and in note 23 to the financial statements.

**Corresponding amount**

29. During the audit of the 2012-13 financial year, I identified the following misstatements which is still included in the corresponding amounts disclosed in the 2013-14 financial statements:

- Accumulated surplus as disclosed in the statement of net assets and statement of financial position is overstated by R4 million.
- Trade receivables from exchange transactions as disclosed in the statement of financial position as well as in note 10 to the financial statements is understated by R3,5 million
- Consumables as disclosed in the statement of financial position and in note 8 to the financial statements.
- Trade receivables from non-exchange transactions as disclosed in the statement of financial position as well as in note 11 is understated by R2,2 million.
- Unspent conditional grants as disclosed in the statement of financial position as well as in note 15 to the financial statements is overstated by R1,1 million.
- Cash generated from operations as disclosed in note 32 to the financial statements is overstated by R2 million.

30. I was unable to obtain sufficient appropriate audit evidence for the corresponding amounts of the above items or to confirm them by alternative means. Consequently, I was unable to determine whether any adjustments to these amounts were necessary. My audit opinion on the financial statements for the period ended 2012-13 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's amounts.

### **Qualified opinion**

31. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Mnquma Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with the South African Standards of Generally Recognised Accounting Practices and the requirements of the MFMA.

### **Emphasis of matters**

32. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of corresponding amounts**

33. As disclosed in the statement of changes in net assets, the corresponding amounts for 30 June 2013 have been restated as a result of errors only corrected during the year ended 30 June 2014 that existed in the financial statements at, and for the year ended 30 June 2013.

### **Material impairments**

34. Disclosed in the statement of financial performance and in note 9 and 10 to the financial statements is an amount R8,7 million (2013: 2 million) for debt impairment that has been impaired as a result of non-payment of consumer debtor accounts.

### **Irregular expenditure**

35. As disclosed in note 42 to the financial statements, irregular expenditure amounting to R59,3 million was incurred by the municipality during the year ended 30 June 2014. This is as a result of non-compliance with procurement requirements.

### **Unauthorised expenditure**

36. As disclosed in note 40 to the financial statements, unauthorised expenditure amounting to R6,5 million was incurred by the municipality during the year ended 30 June 2014.

### **Material underspending of the conditional grant**

37. The municipality has materially underspent the budget on Municipal Infrastructure Grant by R19 million (33% of available budget). This is disclosed in note 21 to the financial statements.

### **Additional matters**

38. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Unaudited supplementary schedules**

39. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

### **Unaudited disclosure notes**

40. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

41. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### **Predetermined objectives**

42. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected objectives presented in the annual performance report of the Mnquma Local Municipality for the year ended 30 June 2014:
  - Basic Service Delivery and Infrastructure Development.
  - Community Services.
43. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
44. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
45. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
46. The material findings in respect of the selected objectives are as follows:

#### **Basic Service Delivery and Infrastructure Development**

##### **Usefulness of reported performance information**

47. Section 41(c) of the Municipal Systems Act, 2000 (Act No.32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 25% of the reported objectives were not consistent with those in the approved integrated development plan. This was due to management not thoroughly reviewing the institutional scorecard to ensure that it aligned to the IDP.
48. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. A total of 29% of the indicators did not relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives as per the service delivery and budget implementation plan. This was because proper performance planning and management practices had not been developed and implemented to provide for the development of performance indicators and targets included in the annual performance service delivery and budget implementation plan.
49. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

##### **Reliability of reported performance information**

50. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of

our work due to the fact that the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

## **Community Services**

### **Reliability of reported performance information**

51. The FMPPi requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. The reported performance information was not valid, accurate and complete when compared to the source information or evidence provided. This was due to a lack of understanding of application of the technical indicator descriptions for the accurate measurement and monitoring of the completeness of source documentation in support of actual achievements.

### **Additional matters**

52. I draw attention to the following matters:

#### **Achievement of planned targets**

53. Information on the achievement of the planned targets for the year is set out on pages x to x and x to x. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected objectives reported in paragraphs 47 to 51 of this report.

#### **Unaudited supplementary schedules**

54. The supplementary information set out on pages XX to XX does not form part of the annual performance report and is presented as additional information. I have not audit these schedules and, accordingly, I do not report thereon.

#### **Compliance with legislation**

55. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

#### **Annual financial statements and annual report**

56. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a qualified audit opinion.

#### **Asset management**

57. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

#### **Audit committee**

58. The audit committee did not advise the council and the accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
59. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.
60. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).

61. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).

#### **Budget**

62. Expenditure was not incurred in accordance with the approved budget, in contravention of section 15 of the MFMA.

#### **Conditional grants**

63. The municipality did not evaluate its performance in respect of programmes or functions funded by the Local Government Financial Management Grant allocation, as required by section 12(5) of the DoRA.

64. The municipality did no evaluate its performance in respect of programmes funded by the:

- Municipal Infrastructure Grant or submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA, 2013 (Act no.2 of 2013).
- Integrated National Electrification Programme or submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA.
- Municipal Systems Improvement Grant or submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA.

65. The Municipal Infrastructure Grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 16(1) of the DoRA.

#### **Consequences management**

66. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

67. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

68. The accounting officer and council did not always report to the South African Police Service cases of alleged irregular expenditure that constituted a criminal offence, as required by section 32(6) and 32(7) of the MFMA.

#### **Expenditure management**

69. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.

70. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors, accounted for payments made, as required by section 65(2)(b) of the MFMA.

71. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### **Human resources management**

72. The competencies of financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by the Municipal Regulations on Minimum Competency Levels Regulation 13 (MRMCLR).
73. A senior manager directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) MSA.
74. The performance agreements of the chief financial officer (CFO), head of supply chain and financial officials who did not have the minimum competencies, did not include the attainment of minimum competencies as a performance target, as required by Municipal Regulations on Minimum Competency Levels regulation (MRMCLR) 16(1) and 16(2)
75. The CFO was appointed without having met the prescribed minimum competency levels and the continued employment in the position was not made subject to meeting such requirements by 1 January 2013, as required by section 56(1)(b) of the MSA and regulation 18(2) on Minimum Competency levels.
76. The competencies of financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by the MRMCLR 13.
77. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the MRMCLR 14(2)(a).
78. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the MRMCLR 14(2)(b).
79. The head of supply chain management did not have the higher education qualification or meet any of the prescribed competency areas as required by section 119 of the MFMA and regulation 10 and 11 of the MRMCLR.
80. Finance officials at middle management and supply chain management managers did not meet the prescribed competency areas as required by regulation 8 and 9 of the MRMCLR.
81. An acting CFO and head of SCM was appointed for a period of more than three months without the approval by the MEC for local government in contravention of section 54A(2A) of the MSA.

### **Internal audit**

82. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, the DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.
83. The internal audit unit did not function as required by section 165(2) of the MFMA, in that it did not advise the accounting officer and report to the audit committee on matters relating to internal controls, accounting procedures and practices and risk and loss control.

### **Strategic and Performance management**

84. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
85. The performance management system of the municipality did not provide for taking steps to improve performance with regard to those development objectives and objectives where performance targets are not met, as required by section 41 (1)(d) of the MSA.

86. The performance management system and related controls were inadequate as it did not describe and represent the processes of performance monitoring, measurement, review, reporting and improvement and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the municipal planning and performance management regulations.
87. The annual performance report for the year under review does not include measures taken to improve performance, as required by section 46 (1)(b) of the MSA.

#### **Procurement**

88. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
89. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) and (c).
90. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
91. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services as required by SCM regulation 28(2).
92. Bid adjudication was also not always done by committees which were composed in accordance with SCM regulation 29(2). Furthermore, the preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act, 2000 (Act No.5 of 2000) and SCM regulation 28(1)(a).
93. Quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
94. Contracts were extended or modified without the approval of a properly delegated official, as required by SCM Regulation 5.
95. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act, 2000 (Act No.38 of 2000) (CIDB Act) and CIDB regulation 18.
96. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
97. Sufficient appropriate audit evidence could not be obtained that:
  - Invitation for competitive bidding was advertised for a required minimum period of days, as required by SCM regulation 22(1) & 22(2)
  - Contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding as required by SCM Regulations 21(b) and 28(1)(a) and Preferential Procurement Regulations.

- Bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
- Bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
- Contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding , as required by SCM Regulations 21(b) and 28(1)(a) and Preferential Procurement Regulations.
- Bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
- Construction contracts were awarded to contractors that were registered with the CIDB and qualified for the contract in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).

#### **Revenue management**

98. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.
99. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.
100. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

#### **Internal control**

101. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the performance report and the findings on non-compliance with legislation included in this report.

#### **Leadership**

102. Leadership did not fulfil its oversight responsibilities with regards to the implementation and monitoring of internal controls and compliance with laws and regulations and did not insist on daily disciplines to ensure sound financial and performance management and compliance with laws and regulations. This resulted in inaccurate, incomplete and inadequate financial and performance reporting.
103. The established and communicated policies and procedures of the municipality were outdated and did not adequately support the municipality in complying with laws, regulations and reporting requirements of GRAP.
104. Although attention was given to the filling of critical vacancies to ensure sufficient capacity to address the on-going control deficiencies, the municipality remained without a full time CFO and SCM and expenditure manager, which compromised the SCM processes and internal control management.
105. Performance of municipal officials was not monitored by those charged with governance and leadership, furthermore, there was lack of consequences for those that deliberately or negligently flouted the SCM regulations.
106. Leadership has not ensured that the audit action plan was approved by council and that it was overseen by governance structures such as MPAC or the finance portfolio committee. It also did not implement the action plans in time to have a meaningful impact on the control

environment. It was also not monitored by the oversight bodies to ensure that action was taken.

107. Sufficient action is not taken by leadership to ensure that consequence management is practiced at the municipality. This lack of action has resulted in officials not being discouraged to continue with unsatisfactory actions and manifests itself in the numerous repeat audit findings in this and other reports.
108. There has not been sufficient, decisive actions have taken to address audit findings of prior years in the form of effective action plans that are properly implemented and many cases the same audit findings that were reported in the prior audit report again repeat themselves in this report.

#### **Financial and performance management**

109. Appropriate daily and monthly processes, procedures and controls were not introduced to ensure that all transactions were accurately recorded, classified, reconciled, approved and reported on, in accordance with GRAP and the FMPPI. Misstatements across all cycles and components signified a lack of review of transactions and balances at all managerial levels within the municipality, including the inadequacy of detection systems to alert management of control failures. Officials did not always fulfil their assigned duties and responsibilities and the performance of staff was further compromised by outdated policies and procedures, and not holding staff responsible and accountable for their actions.
110. The lack of record management and daily financial disciplines continues to have a negative effect on the financial administration of the municipality. A number of reconciliations and registers were only prepared after the financial year-end which did not allow sufficient time for adequate reviews to take place. This resulted in errors that were not detected during the compiling of the financial statements but rather during the audit process.
111. Leadership did not adequately monitor the actions and outputs of officials throughout the year under review to ensure compliance with key legislation such as the MFMA, DoRA and MSA and Municipal Supply Chain Management Regulations, as a result the majority of municipal laws and regulations were not complied with. In addition SCM compliance awareness amongst officials across all functional areas was not at the desired level, as evidenced by the large amount of irregular expenditure reported by management (over 50% of expenditure for the year).

#### **Governance**

112. As in previous years, the municipality failed to take corrective action and follow up on reports issued by internal audit, resulting in repeat findings in the external audit reports. Risk management activities were also not sufficient as evidenced by the large number of repeat findings. The municipality also lacked effective risk monitoring processes in order to ensure risks identified are appropriately managed.
113. The internal audit function lacked sufficient capacity to function effectively and produce reports during the financial year. This hampered the ability of the audit committee to fulfil their oversight function and other compliance responsibilities in terms of the MFMA.
114. Although internal audit unit lacked sufficient capacity to function effectively, most of the audit reports tabled to the audit committee were not essential to seeing the municipality improve its internal control environment and ultimately leading to an improved audit outcome.
115. The audit committee failed to comply with essential requirements of the legislation such as advising the council on matters relating to compliance with legislation, reporting to council on issues raised in the audit report and review of the performance management system.
116. The effectiveness of the internal audit unit and audit committee is compromised by the lack of action taken by management based on their recommendations.

## **OTHER REPORTS**

### **INVESTIGATIONS**

117. Various allegations relating to procurement, appointments and expenditure were investigated by PricewaterhouseCoopers. The report was submitted to council who responded by implementing further investigative processes in order to act on the recommendations of the report.

*Auditor-General.*

East London

28 November 2014



AUDITOR-GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*